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AUTHORITIES CITED.

In the Supreme Court of the United States.

OCTOBER TERM, 1922.

GREENPORT BASIN AND CONSTRUCTION CO., plaintiff in error and appellant, *v.* THE UNITED STATES, DEFENDANT IN ERROR and appellee. } No. 31

IN ERROR TO AND APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK.

BRIEF FOR THE UNITED STATES.

STATEMENT OF THE CASE.

This case is here on writ of error to and on appeal from the judgment of the United States District Court for the Eastern District of New York sustaining a general demurrer to the petition. (269 Fed. 58.)

The appellant, a domestic corporation, brought suit to recover the sum of $4,420.40, the amount of excess profits tax for the year 1917 alleged to have been unlawfully assessed against the appellant and collected by the collector of internal revenue. The tax was assessed upon excess profits under the provisions of section 201 of Title II of the act of October 3, 1917. (40 Stat. 303.)

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Section 201 provides for dividing a taxpayer's income into five classes or brackets, each bracket covering the amount of net income falling within a stated ratio between the taxpayer's net income and his invested capital. The first bracket includes net income "not in excess of fifteen per centum of the invested capital," and the fifth bracket includes net income "in excess of thirty-three per centum of such capital." The section levies a tax at progressive rates upon the amount of income included within each income bracket. Income in the first bracket is taxed at twenty per cent and income in the fifth and last bracket is taxed at sixty per cent.

The meaning of the words "net income" as used in the excess-profits tax provisions of the act of October 3, 1917, is defined in section 206 of the act and the meaning of the words "invested capital" is defined in section 207.

The first income bracket of section 201 provides for taxing only the amount of net income within the bracket which is "in excess of the deduction (determined as hereinafter provided)." The four subsequent income brackets contain no similar clause and make no reference to the "deduction." Section 203 defines the "deduction," which consists of an amount equal to from seven to nine per cent of invested capital, plus $3,000.

The parties in the present case are agreed upon the amount of the appellant's net income and the amount of its invested capital, as well as upon the amount of its "deduction" as authorized by section 203. The

controversy turns solely upon the proper method for giving effect to the deduction in calculating the tax imposed by section 201. The Government contends that the appellant's entire net income should be apportioned among the income brackets of section 201 and that the amount of its authorized deduction should then be subtracted from the amount of income included in the first income bracket. The appellant contends that the authorized deduction should first be subtracted from net income and that net income thus depleted constitutes the net income which is to be apportioned among the income brackets of section 201 for the purposes of the tax. The practical difference between the two methods of calculation is this: Under the Government's method the income subject to taxation at the lowest rate fixed by section 201, namely, twenty per cent, is reduced by the amount of the deduction; under the appellant's method the income subject to the highest applicable rate fixed by section 201 is reduced by the amount of the deduction.

The appellant filed a return with the proper collector of internal revenue showing for the appellant's taxable year ending October 31, 1917, a net income of $76,361.20, an invested capital of $215,615.55, and a deduction of $18,093.08. The petition alleged that the appellant in its return computed its excess-profits tax under the compulsion of the regulations prescribed by the Commissioner of Internal Revenue. The manner in which the appellant's excess-profits

tax was computed is set forth in the table printed herein as Table A.

TABLE A.

Invested capital	$215,615.55
Income	76,361.20
Deduction	18,093.08
Deduction estimated as follows:	
7 per cent of $215,615.55	15,093.08
Specific deduction	3,000.00
	18,093.08

Classes of income.		Income.	Deduction.	Balance subject to tax.	Rate.	Amount of tax.
Over.	But not over.					
1	2	3	4	5	6	7
					Per cent.	
$0.00	15 per cent invested capital.	$32,342.33	$18,093.08	$14,249.25	20	$2,849.85
15 per cent invested capital.	20 per cent invested capital.	10,780.77	None.	10,780.77	25	2,695.19
20 per cent invested capital.	25 per cent invested capital.	10,780.77	None.	10,780.77	35	3,773.27
25 per cent invested capital.	33 per cent invested capital.	17,249.24	None.	17,249.24	45	7,762.15
33 per cent invested capital.		5,208.09	None.	5,208.09	60	3,124.85
Total		76,361.20				20,205.31

Pro rata for fiscal year: Five-sixths of $20,205.31=$16,837.76.

The appellant's excess profits tax, as shown by the return filed by it, was $16,837.76 for the taxable year 1917. A tax in this amount was assessed against the appellant by the proper collector of internal revenue and was paid by the appellant. (R. 2.)

At the time of filing its return the appellant appealed to the Commissioner of Internal Revenue and filed with the collector of internal revenue a claim for refund, alleging that its excess profits tax for the taxable year 1917 was $12,417.36, and that it was, therefore, entitled to a refund of $4,420.40.

The petition further alleges that more than six months had elapsed since the filing of this appeal and this claim for refund, but that the commissioner had not rendered a decision upon the appeal or the claim for refund, and that no refund had been made or ordered. (R. 2.)

The claim for refund alleged that the Treasury regulations governing the computation of the excess profits tax were illegal, and that they resulted in the assessment against the appellant of a greater tax than was authorized by law. It asserted that appellant's excess profits tax should have been computed according to the method set forth in the table printed herein as Table B.

TABLE B.

Net income	$76,361.20
Deduction	18,093.08
Balance subject to tax	58,268.12

Classes of income.		Income.	Rate.	Amount of tax.
Over.	But not over.			
1	2	3	4	5
			Per cent.	
$0.00	15 per cent invested capital	$32,342.33	20	$6,468.47
15 per cent invested capital	20 per cent invested capital	10,780.77	25	2,695.19
20 per cent invested capital	25 per cent invested capital	10,780.77	35	3,773.25
25 per cent invested capital	33 per cent invested capital	4,364.25	45	1,963.91
33 per cent invested capital			60	
Total		58,268.12		14,900.82

Pro rata for fiscal year: Five-sixths of $14,900.82=$12,417.36.

APPLICABLE PROVISIONS OF ACT OF OCTOBER 3, 1917.

SEC. 200. * * * The term "taxable year" means the twelve months ending December thirty-first, excepting in the case of a corporation or partnership which has fixed its own fiscal year, in which case it means such fiscal year. * * *

SEC. 201. That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income:

Twenty per centum of the amount of the net income in excess of the deduction (determined as hereinafter provided) and not in excess of fifteen per centum of the invested capital for the taxable year;

Twenty-five per centum of the amount of the net income in excess of fifteen per centum and not in excess of twenty per centum of such capital;

Thirty-five per centum of the amount of the net income in excess of twenty per centum and not in excess of twenty-five per centum of such capital;

Forty-five per centum of the amount of the net income in excess of twenty-five per centum and not in excess of thirty-three per centum of such capital; and

Sixty per centum of the amount of the net income in excess of thirty-three per centum of such capital.

SEC. 203. That for the purposes of this title the deduction shall be as follows, except as otherwise in this title provided—

(a) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) $3,000.

SEC. 206. That for the purposes of this title the net income of a corporation shall be ascertained and returned * * * for the taxable year upon the same basis and in same manner as provided in Title I of the act entitled "An act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, as amended by this act, except that the amounts received by it as dividends upon the stock or from the earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by Title I of such act of September eighth, nineteen hundred and sixteen, shall be deducted.

ARGUMENT.

The progressive tax rates fixed by section 201 are based upon the ratio between net income and invested capital. They can not, therefore, be based upon the ratio between net income depleted by a "deduction" and invested capital.

In construing section 201 of the act of October 3, 1917, it is important to bear in mind that section 206 exactly defines the meaning of the words "net

income" as used in the excess-profits tax provisions of that act. Section 206 states how "net income" shall be computed, and when the net income of a taxpayer has been ascertained according to the provisions of this section, the amount thus ascertained may be substituted for the words "net income" wherever they appear in the excess-profits tax provisions of the act.

The initial requirement of section 201 is that a tax shall be levied "equal to the following percentages of the net income." This implies that all of the net income is to be included within one or another of the succeeding income brackets. The appellant's net income for the taxable year was $76,361.20; therefore this amount is to be included among the income brackets or classifications of section 201. The collector of internal revenue followed this requirement and apportioned among the income brackets of the section the sum of $76,361.20.

The appellant, on the other hand, contends that section 201 permits it to subtract from net income the amount of the deduction authorized by section 203 and to apportion among the income brackets of the section, not net income, but net income less the deduction. By its method of computation only $58,258.12 is included in the income brackets of the section. By this computation a tax is not levied "equal to the following percentages of the net income," as required by section 201, but a tax is levied "equal to the following percentages of the net income less the deduction as hereinafter provided."

The appellant's method of computation is therefore a direct violation of the terms of section 201.

If section 201 contained no provision giving effect to the deduction authorized by section 203, there might be some basis for the appellant's contention that, although section 206 explicitly fixes the meaning of the words "net income," they nevertheless are used in section 201 to mean not "net income," but "net income less the deduction authorized by section 203." This construction is, however, impossible in view of the fact that the first income bracket of section 201 provides for making the deduction authorized by section 203. It reads:

> Twenty per centum of the amount of the net income in excess of the deduction (determined as hereinafter provided) and not in excess of fifteen per centum of the invested capital for the taxable year.

The bracket covers income "in excess of" the deduction and "not in excess of" fifteen per cent of invested capital, in other words, the difference between these two amounts. It is therefore necessary in order to ascertain the amount of income falling within this bracket to take income equal to fifteen per cent of invested capital and subtract from this the amount of the deduction authorized by section 203. If the deduction should equal or exceed fifteen per cent of invested capital, no income would remain to which the applicable twenty per cent rate would attach.

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The collector of internal revenue calculated the amount of appellant's income taxable under the first bracket according to its requirements. From income equal to fifteen per cent of invested capital, namely, $32,342.33, he subtracted the deduction of $18,093.08, and applied the twenty per cent rate to the remaining amount of $14,249.25.

The computation made by the appellant, on the other hand, puts the entire sum of $32,342.33 in this bracket and applies the twenty per cent rate to this amount. Appellant's computation is therefore in violation of the terms of the bracket and could be made only if the bracket read somewhat as follows:

> Twenty per centum of the amount of net income remaining after making the deduction (determined as hereinafter provided) applied to an amount not in excess of fifteen per centum of the invested capital for the taxable year.

The succeeding brackets cover income equal to stated ratios to the invested capital, and the fifth and last bracket covers "the amount of the net income in excess of thirty-three per centum of such capital."

Thirty-three per cent of the appellant's invested capital for the taxable year is $71,153.13. If this amount is subtracted from its net income of $76,361.20, there remains $5,208.07 as the income falling within the fifth bracket. Under the computation made by the collector of internal revenue $5,208.09 was included within this bracket (the difference of

two cents being due to fractions of a cent eliminated in prior brackets). The computation of the collector is therefore a strict compliance with the provisions of the bracket and a tax was levied at the rate of sixty per cent of the amount within the bracket. Since by the appellant's computation no income whatsoever falls in the last bracket, its computation is directly contrary to the terms of this bracket.

The Government submits that the wording of section 201 in no instance sustains the interpretation which the appellant has sought to give to the section, but that it clearly authorizes the method by which the collector of internal revenue computed the appellant's excess profits tax.

The appellant has quoted *LaBelle Iron Works* v. *United States*, 256 U. S. 377, as supporting its interpretation of section 201 (brief, pp. 11–13), but the Government submits that the court in that case adopts the Government's construction of the section. The principal question there decided was that "invested capital," as defined in section 207 of the act of October 3, 1917, does not include the appreciation in value of property owned by a corporation. In approaching this question the court summarized the excess profits tax provisions of the act as follows (p. 383):

> As applied to domestic corporations, the scheme of this title was that, after providing for a deduction from income (section 203, p. 304) * * * it imposed (section 201, p. 303), in addition to other taxes, a graduated tax

> upon the net income beyond the deduction, commencing with twenty per centum of such net income above the deduction but not above fifteen per centum of the invested capital for the taxable year, and running as high as sixty per centum of the net income in excess of thirty-three per centum of such capital.

The court describes the twenty per cent tax as applying to income which is "above the deduction" and which does not exceed fifteen per cent of invested capital, but in the case of the sixty per cent rate the court does not refer to the deduction and describes it as applying to all income above thirty-three per cent of invested capital. This description of the sixty per cent rate is inconsistent with the appellant's view that the sixty per cent rate covers only the amount by which net income less the deduction exceeds thirty-three per cent of invested capital.

The method by which the collector of internal revenue computed the appellant's excess profits tax is further sustained by the decision of Judge Thompson in *Ehret Magnesia Mfg. Co.* v. *Lederer*, 273 Fed. 689. The court there gave judgment for the defendant in a suit in which the plaintiff sought to recover excess profits taxes upon the same theory upon which the appellant seeks recovery in this suit.

When the meaning of an act is doubtful, its legislative history may be referred to as an aid in discovering what the legislature intended it to mean. (*Holy Trinity Church* v. *United States*, 143 U. S. 457; *United States* v. *St. Paul, M. & M. Ry. Co.*, 247 U. S. 310.)

As originally adopted by the House, the excess-profits tax deduction was the same as it was in the preceding act of March 3, 1917 (39 Stat. 1000), namely, eight per cent of invested capital plus $5,000. (Cong. Rec., 65th Cong., first sess., vol. 55, pt. 7, p. 7580.) The Senate struck out the entire excess-profits tax title of the House bill and substituted as a basis for exemption the percentage of profits made during the years 1911, 1912, and 1913. (Cong. Rec., 65th Cong., first sess., vol. 55, pt. 7, p. 7581.) The conference committee of the two Houses then agreed upon the tax as enacted into law. Mr. Kitchin presented the conference report to the House on October 1, 1917, and in concluding his explanation of the conference report asked unanimous consent to extend his remarks in the Record "and to append some tables which may prove instructive and useful in the study of the revenue bill as agreed on by the conference committee." (Cong. Rec., 65th Cong., first sess., vol. 55, pt. 7, p. 7586.)

Immediately following Mr. Kitchin's remarks sixteen tables dealing with computation of the excess-profits tax are printed in the Record. The method of computation used in these tables is the same method used by the collector in computing the appellant's excess profits tax.

The tables printed as an extension of Mr. Kitchin's remarks show the view of the conference committee as to the meaning of the law. This view was, moreover, presented to the House before passage of the bill. Mr. Fordney, in explaining the conference re-

port on the revenue bill, said: "If the pending bill is enacted into law, the following table shows the total amount of income, corporation, and excess-profits taxes that would be paid * * *." He then gave six tables in which the excess-profits tax were computed on the same basis as that used by the collector in the present case. (Cong. Rec., 65th Cong., 1st sess., vol. 55, pt. 7, pp. 7592, 7593.)

Subsequently to the passage of the act of October 3, 1917, Congress indicated its approval of the method employed by the Treasury Department in computing the excess-profits tax imposed by that act.

Section 301 (a) of the act of February 24, 1919 (40 Stat. 1088), levied an excess-profits tax upon corporations for the taxable year 1918, and section 301 (b) levied a similar tax for subsequent taxable years. In both sections 301 (a) and 301 (b) income was divided into two brackets based upon the ratio of net income and invested capital, and income in the second bracket was taxed at a higher rate than income in the first bracket. Section 312 provided for an "excess-profits credit" similar to the deduction authorized by section 203 of the act of October 3, 1917. Section 301 (d) of the later act provided:

> In any case where the full amount of the excess-profits credit is not allowed under the first bracket of subdivision (a) or (b), by reason of the fact that such credit is in excess of twenty per centum of the invested capital, the part not so allowed shall be deducted from the amount in the second bracket.

If the appellant's method of computation were followed, the "excess-profits credit" would be subtracted before any income would be apportioned among income brackets. There would therefore never be a case "where the full amount of the excess-profits credit is not allowed under the first bracket." The fact that section 301 (d) made specific provision for such cases shows that Congress did not intend appellant's computation to be employed under the act of February 24, 1919, which taxes excess profits upon the same basis as did the act of October 3, 1917.

Certain regulations declaring the Treasury Department's construction of the act of October 3, 1917, were published by it as "Regulations No. 41." Article 17 of these regulations declared that in any case where the deduction authorized by section 203 was greater than the amount of income falling within the first bracket of section 201 "then any remaining portion of the deduction will be allowed under the second bracket, and continued if necessary into the succeeding bracket or brackets until the entire amount of deduction is allowed." This regulation prevented the taxpayer from suffering any hardship if its authorized deduction could not be entirely absorbed in the first income bracket.

The appellant contends that the collector's method of computation is unfair to small corporations because they may be taxed only at the sixty per cent rate, whereas a larger corporation with an equal percentage of profit will be taxed both at the lower rates provided in section 201 and at the sixty per cent

rate. (Brief, pp. 18–19, 24–25; additional brief, pp. 18–19.) Certainly the sixty per cent rate applying alike to all corporations on income above thirty-three per cent of invested capital is neither unjust nor unequal in its application. The fact that under the Treasury regulations small corporations might escape additional taxation at the lower rates provided in section 201, instead of being a hardship on such corporations, was a special advantage which they enjoyed because the deduction authorized by section 203 gave them a relatively larger relief from taxation.

The appellant contends that the Government's method of computation is inconsistent with that employed in other revenue cases. (Brief, pp. 16–17; additional brief, pp. 6–8.) No real analogy exists except in the case of laws involving progressive rates of tax. The income tax acts furnish such analogy and the methods there applied are similar to those adopted in this case.

Under the income-tax laws surtaxes are imposed on the basis of the taxpayer's net income without any allowance for exemptions or credits. Exemptions or credits are subtracted only from the amount subject to the normal tax. (Act of September 8, 1916, section 7 (a) [39 Stat. 761]; act of October 3, 1917, section 3 [40 Stat. 301]; act of February 24, 1919, section 216 [40 Stat. 1069]; act of November 23, 1921, section 216.) To subtract the deduction authorized by section 203 of the act of October 3, 1917, from income falling within the first bracket of

section 201 is analogous to the procedure under the income-tax laws of subtracting authorized exemptions or credits from the income subject to the normal tax. Under both schemes of taxation the exemption is for the benefit only of the income upon which the lowest rates of tax are imposed.

The Government submits that the wording of section 201 of the act of October 3, 1917, clearly authorized the method by which the collector computed the appellant's excess-profits tax; that the conference committee which drafted the excess-profits tax provisions of the act of October 3, 1917, intended the excess-profits tax to be computed upon the basis employed by the collector in this case; that this method of computation was approved by Congress in the excess-profits tax provisions of the act of February 24, 1919; and that the collector's method of computation is just and fair in its application.

The Government, therefore, requests this court to affirm the judgment of the United States District Court for the Eastern District of New York sustaining a general demurrer to the petition.

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OCTOBER, 1922.

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